Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated With Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms	)	CC Docket No. 98-171
	)	
Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990	)	CC Docket No. 90-571
	)	
Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size	)	CC Docket No. 92-237 NSD File No. L-00-72
	)	
Number Resource Optimization	)	CC Docket No. 99-200
	)	
Telephone Number Portability	)	CC Docket No. 95-116
	)	
Truth-in-Billing and Billing Format	)	CC Docket No. 98-170

REPLY COMMENTS OF VERIZON ON CONTRIBUTION MECHANISM AND COMMENTS ON STAFF STUDY

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REPLY COMMENTS OF VERIZON[1] ON CONTRIBUTION MECHANISM AND COMMENTS ON STAFF STUDY

I. Introduction and Summary

The existing revenue-based mechanism for assessing contributions to universal service from telecommunications carriers is an effective means of funding universal service consistent with section 254 of the Act. The Commission found there were some inequities in that system, but it also found that it could correct those inequities without abandoning the basic approach and has done so. While there are claims in the record here that industry changes require an entirely new approach to universal service contributions, those claims are premature or otherwise cannot withstand scrutiny. Rather than rushing to adopt a new plan, the Commission should wait until it gains experience with the modifications recently made to the existing mechanism – modifications that just became effective on April 1 – and use that experience to evaluate what, if any, additional changes are needed in light of the evolving telecommunications marketplace and to ensure that any revised mechanism is fully consistent with statutory requirements.

The Commission's Staff Study[2] reinforces the fact that there is no need to scrap the existing contribution mechanism at this time. It shows that, contrary to the claims of some parties, there is no "death spiral" of reduced interstate telecommunications revenue that will in short order undermine the contribution base and force adoption of an entirely new mechanism.

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[1] This filing is made on behalf of the Verizon telephone companies and affiliated long distance companies (collectively, "Verizon"). The Verizon telephone companies are the affiliated local telephone companies of Verizon Communications Corp. These companies are listed in Attachment A. The Verizon affiliated long distance companies participating in this filing are Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance, NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions, and Verizon Select Services, Inc.

[2] *See Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, Public Notice, CC Docket No. 96-45 *et al.*, FCC 03-31 (rel. Feb. 26, 2003) ("Staff Study").

In fact, according to the Staff Study, the contribution base will be no lower in 2007 than it was in 2002.

The Staff Study also shows the dramatic effect of the various connection- or telephone number-based contribution proposals on the distribution of contributions by industry segment. All would substantially reduce the share paid by interexchange carriers and increase those of local exchange and wireless carriers. The Commission must examine these impacts and reject shifts that are not fully consistent with the requirements of section 254(b) of the Act that contributions are to be paid on an equitable and nondiscriminatory basis by all carriers that provide interstate telecommunications services.

II. There Is No "Death Spiral" of Reduced Revenue That Requires Near-Term Replacement of the Existing Contribution Mechanism.

Some parties claim that the existing universal service contribution base – end-user interstate revenues – is being quickly eroded to the degree that the existing revenue-based contribution mechanism is no longer sustainable. *See, e.g.,* AT&T at 11-18, Sprint at 4-6, WorldCom at 6-9. The Commission's own Staff Study, however, belies that claim. It projects that the universal service revenue base will remain relatively flat over the next five years, increasing modestly after 2002 and then declining about the same amount by 2007. *See* Staff Study at 5.[3]

[3] The Staff Study shows a projected increase in the contribution base from 2002 to 2003 of about 4.6%, from $76.4 billion to $80.1 billion. That level is expected to remain fairly constant until 2006 and 2007, when it is projected to decline to $78.9 billion and $76.7 billion, respectively, or just a little higher than the 2002 level.

Other parties here also dispute the "death spiral" claim. NASUCA, for example, points out that "the record shows that the patient is nowhere near critical condition," NASUCA at 13-14. *See, also* TracFone Wireless at 8.

The moderate downward interstate revenue trend projected for 2006 and 2007 in the Staff Study should be taken into account in any Commission decision on revising the contribution mechanism, but it certainly does not warrant precipitous action. Instead of quickly abandoning the existing mechanism, the Commission should evaluate the results of the changes it has recently made to the existing contribution mechanism and complete pending proceedings before considering adoption of a completely new mechanism, as discussed below. Deliberate, rather than precipitous, action to revise the universal service contribution rules, to the extent further revision is found to be needed, will help ensure that any such revisions are sustainable over the long term.

III. The Growth of Bundled Offerings Does Not Make A Revenue-Based Mechanism Unsustainable.

Just as there is no "death spiral" that mandates quick action, the fact that some carriers, including Verizon, are bundling interstate and local services and offering integrated packages to their customers does not warrant immediate abandonment of the existing revenue-based contribution mechanism, as some parties claim. *See, e.g.,* AT&T at 15-18, SBC/BellSouth at 7-8, WorldCom at 11-13. As these types of plans grow, they may justify considering alternative assessment methods. But the market for these bundled offerings is still evolving, and the Commission should allow time for that evolution before altering its contribution method.

Moreover, the current system can reasonably address the bundled offerings that exist today. Verizon, for example, markets local and long distance service at a single rate, but the services are actually provided by separate entities. The interstate portion of the Verizon local exchange company's revenue is tracked and reported to the Commission under the jurisdictional separations process, 47 C.F.R. Part 36, while the long distance company separately tracks the interstate and intrastate portion of its interexchange revenues. For carriers that cannot as readily separate their services, the Commission can establish proxy allocations. As NASUCA points out, the Commission has historically found ways to allocate costs and revenues under similar circumstances, and there is no reason a similar allocation mechanism cannot be adopted here. *See* NASUCA at 6-7. As two examples, it points to the jurisdictional separations formula for allocating joint and common network costs between the interstate and intrastate jurisdictions and the wireless revenue "safe harbor" adopted in this proceeding. *Id.* Similarly, TracFone Wireless points to Commission-endorsed safe harbors in cases where regulated telecommunications services are bundled with unregulated CPE or information services. TracFone Wireless at 12.

Similar factors or formulas can be developed should they prove to be needed to allocate the interstate revenue portion of bundled interstate/intrastate offerings under a revenue-based contribution system. Such factors or formulas could be derived, for example, from public information on the actual usage of network services using call detail, percent interstate usage, and/or special studies if additional data are required. Just as the Commission has developed and recently revised a safe harbor percentage of the revenues of wireless carriers that are subject to federal universal service assessment, it could do the same for wireline providers that offer bundled services.

IV. The Result of Recent Revisions To The Existing Contribution Mechanism Should Be Evaluated and Pending Proceedings Resolved Before Deciding Whether To Adopt Any Entirely New Mechanism.

A number of parties properly point out that the Commission has only recently adopted significant revisions to the existing revenue-based contribution mechanism and urge it to gain experience with operating under those revisions and determine if they solve any remaining perceived shortcomings before deciding whether to scrap the revenue-based approach entirely. *See, e.g.,* NTCA at 2, CTIA at 2-3, Consumers Union *et al.* at 3-4. Those revisions became effective on April 1, 2003, so it is far too early to assess their effectiveness.

Other parties joined Verizon in pointing to other pending rulemakings, including the Broadband, IP Telephony, and ETC Portability proceedings, that could significantly impact the size of the revenue base and the high-cost fund size and urge the Commission to defer any decision here until it decides the issues in those proceedings. *See* Montana Ind. Telecom. Sys. at 7-8, NASUCA at 16, Verizon at 5-6.

The need to decide the broadband proceeding in advance of any decision here is illustrated by the Staff Study, which does not assess cable modem broadband service while assessing 16 contribution shares for each local exchange and wireless carrier's broadband connection in the analysis of proposal 2 and one contribution share under proposal 1. *See* Staff Study at 6-7. Such an assessment, particularly the 16 assessments under proposal 2, would artificially increase the price of local exchange and wireless carriers' broadband services and have a chilling effect on demand, regardless of how cable modem services are assessed.[4] However, if local exchange and wireless carriers' broadband services incur such a high charge

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[4] If a contribution share is $0.72/month, for example, a 16 share assessment would increase the price by $11.52 per month.

(or any charge) but cable broadband services are not assessed at all, then those carriers would not only suffer reduced demand based on the higher market price, but they would also be placed at a severe competitive disadvantage. The Staff Study, therefore, shows why it is imperative as a matter of regulatory policy for the Commission to treat competing services the same.

Moreover, differential treatment of broadband services raises serious First Amendment concerns. Broadband services are the microphone through which local exchange and wireless carriers, like their cable competitors, deliver a form of speech – both their own Internet and other content services – to their customers. As such, the ability of the carriers to employ their facilities for expressive purposes constitute a form of protected speech that is subject to heightened First Amendment scrutiny.[5]

This heightened scrutiny must be applied here, because imposing universal service contribution requirements on the broadband services of the local exchange and wireless carriers but none on the competing services of cable companies necessarily increases the price of the carriers' services, reduces the demand for those services, and allows the carriers to speak to fewer customers. This is just like imposing a tax on newsprint but not on magazines or other competing media, a discriminatory taxation that the Supreme Court condemned under the first Amendment. *See, e.g.*, *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460

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[5] For example, every court to consider the issue found that prohibiting telephone companies from providing video programming over their facilities within their service territories, *see* 47 U.S.C. § 533(b) (1985), *repealed by* Telecommunications Act of 1996 § 302(b)(1), Pub. L. No. 104-104, 1996 U.S.C.C.A.N. (110 Stat. 124), violated the First Amendment. *See, e.g.*, *Southern New Eng. Tel. Co. v. United States*, 886 F. Supp. 211 (D. Conn. 1995); *Chesapeake & Potomac Tel. Co. v. United States*, 42 F.3d 181 (4th Cir. 1994), *vacated on other grounds*, 516 U.S. 415 (1996); *US West v. United States*, 48 F.3d 1092 (9th Cir. 1994), *vacated on other grounds*, 516 U.S. 1155 (1996); *NYNEX Corp. v. United States*, No. 93-323-P-C (D. Me. Dec. 8, 1994); *Ameritech Corp. v United States*, 867 F. Supp. 721 (N.D. Ill. 1994); *Bell South Corp. v. United State*s, 868 F. Supp. 1335 (N.D. Ala. 1994).

U.S. 575, 585 (1983) ("Differential taxation of the press . . . places such a burden on the interests protected by the First Amendment that we cannot countenance such treatment unless the State asserts a counterbalancing interest of compelling importance that it cannot achieve without differential taxation"). And the courts have made clear that First Amendment scrutiny is particularly unforgiving where, as here, government regulation imposes disparate regulatory burdens on similarly situated expressive media. *See, e.g. News Am. Publ'g, Inc. v. FCC*, 844 F.2d 800, 804-05 (D.C. Cir. 1988); *Turner Broad. Sys. v. FCC*, 512 U.S. 622, 659 (1994); *City of Ladue v. Gilleo*, 512 U.S. 43, 51 (1994); and *City of Cincinnati v. Discovery Network*, 507 U.S. 410, 424 (1993). Therefore, continued differential treatment of broadband services fails on First Amendment grounds.

In its recent order that based contributions on projected, rather than historical, interstate revenues, limited the amount of recovery from end-user customers, and increased the wireless "safe harbor," the Commission remedied what it believed were shortcomings in the prior mechanism without abandoning its revenue-based structure. *See Federal-State Joint Board on Universal Service,* Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 96-45, FCC 02-329, ¶¶ 21-51 (rel. Dec. 13, 2002) ("Report and Order and 2d FNPRM"). If, as some parties suggest, these measures "will likely be sufficient to ensure the long-term stability of the USF," Consumers Union *et al.* at 3, then no further revisions to the contribution mechanism will be needed. But the Commission cannot know if this will be the case until it has had a period of time to assess the impact of these changes. Moreover, if it ultimately decides to adopt a new mechanism, the experience with the revised revenue-based mechanism should help it craft a viable system for the long term.

Therefore, until the Commission decides the open proceedings that could substantially affect the size of the universal service fund and the contribution base and gains experience with the revised revenue-based system, it cannot make a reasoned judgment regarding the long-term viability of the existing revenue-based approach and determine whether any of the proposals here are superior. Since there is no reason to rush to judgment, the Commission should defer final action until it can base a decision on all relevant facts.

V. Any Revised Mechanism Must Meet Statutory Requirements.

Section 254(d) of the Act requires that

> [e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service.

47 U.S.C. § 254(d).

Verizon showed in its initial comments that at least two of the connection-based proposals would need to be revised to meet this requirement. In particular, the minimum contribution from interstate carriers, which the Commission proposed at 1% of revenues in proposal 1, *see* Report and Order and 2d FNPRM at ¶ 78, would need to be increased significantly to meet the "equitable and nondiscriminatory" mandate. A similar minimum contribution would also be needed for proposal 3 (charging for each working telephone number). *See* Verizon at 9-11.

Other commenters also recognize the inadequacy of the proposed minimum contribution amounts. For example, Fred Williamson and Associates points out that a 1% minimum contribution "is not equitable" and should be increased to an amount approaching the current contribution percentage, which was about 7% when the comments were filed and is now 9.1%.

Fred Williamson and Associates at 12. *See also*, Virgin Mobile USA at 5-7, NASUCA at 23-24, which likewise discuss the inadequacy of the 1% minimum contribution.

By contrast, several parties claim that the Commission may lawfully adopt a contribution mechanism that effectively excludes interstate carriers. *See,* AT&T at 39-41, Ad Hoc at 6-7, WorldCom at 25-27. They base this conclusion on statutory language that allows the Commission to exempt a carrier or class of carriers from contributing to universal service "if the carrier's telecommunications activities are limited to such an extent that the level of such carrier's contribution … would be de minimis." 47 U.S.C. § 254(d). They argue that, if the Commission adopts a connection-based (or telephone number-based) mechanism without a minimum contribution, then providers of interstate service that have few or any connections to end users would have *de minimis* contributions and may lawfully be excluded. They are wrong.

First, the *de minimis* exclusion does not even apply to interstate telecommunications carriers. Under the statutory language, that exclusion applies only to carriers whose *telecommunications activities* are limited. Carriers whose primary or major business is to provide long distance telephone service or other interstate telecommunications services certainly do not have limited amounts of telecommunications activities. Therefore, the *de minimis* exception in the Act would not apply to them in any event.

Second, the argument of the proponents is entirely circular. They claim that the Commission may lawfully establish a mechanism that excludes interstate carriers, despite the clear statutory language that contributions must be assessed from "[e]very telecommunications carrier that provides interstate telecommunications services." *Id.* Then they claim that such a mechanism is lawful because it makes the contribution from such carriers *de minimis*. But if the mechanism itself is inconsistent with the Act, it cannot be validated under the *de minimis* exception.

Therefore, in order to pass legal muster, any mechanism the Commission adopts must ensure that essentially *all* providers of interstate telecommunications services pay an equitable and nondiscriminatory share of the universal service contribution. But, as the Staff Study shows, all of the connection-based contribution proposals would shift much of the contribution away from such providers. From 59% in 2002, proposal 1 would reduce the share paid by interexchange carriers by 2007 to 22%, proposal 2 to 29%, and proposal 3 to 13%. Staff Study at 6-8. The resulting shift in contribution obligation would fall to local exchange and wireless carriers, in differing amounts. *Id.*[6]

This diversion of the contribution assessment from interexchange carriers to local exchange and wireless providers raises serious issues as to whether the proposals meet the statutory requirement. As a result, the burden is much greater on the proponents to show that each proposal assesses every telecommunications carrier that provides interstate service, and that the contributions from such carriers are equitable and nondiscriminatory. The record to date does not show that all of the proposals meet these requirements without such modifications as raising the minimum contribution level in proposals 1 and 3 well above the 1% level the Commission proposed.

In addition, virtually all of the interexchange carriers' contribution under proposals 1 and 3 is derived from their special access and private line services. They would pay nothing into the

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[6] Proposals 1 and 3 would divert the bulk of the contribution to local exchange carriers, while proposal 2 would divert a higher amount to wireless service providers. *Id.*

fund for their switched long distance services, from which they derive the bulk of their revenues, a result that may not meet the requirements of section 254(d).

In its defense of proposal 3, the telephone number-based assessment, AT&T claims that it would eliminate the need to retain a Centrex-PBX equivalency ratio, because "[s]tations on a PBX system are *usually* assigned unique Direct Inward Dial (DID) numbers." AT&T at 33 (emphasis added). Therefore, AT&T argues, "both Centrex and PBX-served stations would be assessed to the extent they are uniquely addressable from the PSTN by means of an assigned telephone number." *Id.* The problem with this argument is that there are many PBXs that do not assign a unique telephone number to each station and, therefore, would not pay a contribution for each station. They are still connected to the public switched network using a "main" or "pilot" telephone number, for which they would presumably incur only a single assessment.[7] And, if AT&T's proposal were adopted, it reasonable to expect that PBX users would reconfigure their systems to minimize use of separate telephone numbers in order to avoid universal service charges. In those instances, Centrex customers would pay a significantly higher universal service assessment than PBX customers with the same number of stations. This would be discriminatory and inequitable, in violation of section 254(d). The Commission, in the Further Notice here, recognized that inequity and discrimination in proposing to retain the existing Centrex/PBX equivalency ratio under proposals 1 and 2. *See* Report and Order and 2d FNPRM

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[7] The Staff Study appears to bear this out, because it assumes that there are an average of approximately 4 telephone numbers assigned to each multi-line business customer who uses a PBX or key system. The number of stations behind the average PBX or key system is significantly greater than 4, as the Commission found in establishing the 9:1 PBX/Centrex equivalency ratio. *See Access Charge Reform,* 12 FCC Rcd 16606, ¶ 38 (1997). As a result, there are many stations that are not assigned telephone numbers from the public switched network and would not be assessed for universal service under proposal 3.

at ¶¶ 76 and 87. For the same reason, it should retain the equivalency ratio if it adopts proposal 3.

VI. The Commission Must Allow Carriers To Recover Their Costs of Administering Universal Service.

In its opening comments, Verizon showed that any contribution mechanism the Commission adopts must give carriers the right to recover their administrative costs. *See* Verizon at 6. Verizon demonstrated that the costs of changing its systems to accommodate new billing mechanisms can be significant. *See* Comments of Verizon on Petitions for Reconsideration and Clarification at 4 (filed Feb. 27, 2003). The recent Recommended Decision of the Federal-State Joint Board on Universal Service regarding Lifeline and Link-Up services recommends adding some requirements that would significantly increase the carriers' initial implementation and ongoing administrative costs. For example, the Joint Board recommended that carriers be required to notify Lifeline recipients in advance of being charged full rates that they are no longer eligible for Lifeline and that the carriers should be required to implement an appeal procedure. *See Federal-State Joint Board on Universal Service,* Recommended Decision, CC Docket No. 96-45, FCC 03J-2, ¶ 29 (rel. Apr. 2, 2003). It also recommended that all states be urged to adopt an automatic enrollment process, even though it recognized the "additional administrative burden and cost" of such a process., *id.* at ¶ 40, and that they adopt an annual verification process, both of which would be administered in part by the carriers. *Id.* at ¶ 43. In its comments to the Joint Board, Verizon showed why those proposals should not be adopted.

See Comments of Verizon, CC Docket No. 96-45 and FCC 01J-2 at 6-7 (filed Dec. 31, 2001).[8] If, however, the Commission or additional states nonetheless decide to impose such new administrative burdens, the result would be a further increase in the carriers' costs of administering universal service that they should have the right to recover through explicit charges.

VII. Conclusion

Accordingly, the Commission should study the effect of the recent modifications to the existing universal service contribution mechanism and resolve pending proceedings before it decides whether to replace the existing system with any of the proposals. It must also ensure than any new mechanism it adopts fully meets the requirements of section 254(d) that every carrier that provides interstate telecommunications service contributes to universal service on an equitable and nondiscriminatory basis.

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[8] Verizon showed that automatic subscribership is not only expensive, but it does not increase subscribership, is inconsistent with the Commission's competitive policies because it is limited to a single carrier, that agencies that administer the program cannot always provide the carrier with the information needed to facilitate enrollment, and some subscribers object to being enrolled without their consent.

ATTACHMENT A

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.

ATTACHMENT A

CERTIFICATE OF SERVICE

I hereby certify that, on this 18th day of April, 2003, copies of the foregoing "Reply Comments of Verizon on Contribution Mechanism and Comments on Staff Report" were sent by first class mail, postage prepaid, to the parties below.

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